WINTER 2012

NORTHWOOD FAMILY OFFICE

ALSO IN THIS ISSUE:

President's Message

Tom McCullough

2011 is hard to describe. When discussing the markets, perplexing, is a word that comes to mind. The S&P 500 significantly outperformed the TSX by nearly 1300 basis points. Emerging markets, thought to be an all but certain growth region, were anything but. And who could have predicted that bonds would outperform gold (bonds were up 9.67%, long bonds up more than 18%).

So here we are in 2012. As if the past year wasn't harrowing enough, the ancient Mayan calendar predicts the end of the world in December of this year. On the other hand, it's also the 60th jubilee of Queen Elizabeth II's reign, the summer Olympics in London, the U.S. presidential election and the year of the Dragon in the Chinese calendar. In other words, just another normal year in this eventful century! On that note, we wish each of you all the best in the days ahead.

My topic in this letter today is your **'hassle map'**. What is a hassle map? It is the combination of problems and frustrations consumers experience when they use a product or service. "Think about the last time you traveled by plane, challenged an incorrect cell phone bill, or dealt with any large and unresponsive bureaucracy. Think about each extra step, wasted moment, avoidable risk, needless complication, less-than-optimal solution, awkward compromise, and disappointing outcome" (from *Demand*). Some of these hassles you barely notice anymore because they're so familiar—but if someone were able to fix them, you would switch for sure.

The idea comes from Adrian Slywotzky in his recent book *Demand: Creating What People Love Before They Know They Want It*. I heard him speak at the Rotman School of Management this past fall and have since read his book. In it, he cites examples of a number companies and products that have not only reduced consumer frustration with existing solutions, but also turned users into enthusiastic fans -- iPad, Nespresso, Kindle, ZipCar, the Eurostar train (that runs under the English Channel) and Wegman's (a U.S. grocery store) -- just to mention a few.

It also has application in the financial and investment field. Since reading this book, I have been asking people I meet with to describe their own financial hassle map. In one such interaction with an affluent entrepreneur last month, I heard a pretty typical list of things that drive people crazy about the current options available for effectively managing their investments and personal financial affairs.

Here's what he said: "I have no effective 'bring forward' system to make sure important tasks get done, and this weighs me down. I have a long-term but unsatisfactory relationship with my broker and need to break away. My cash management is poor and I often find myself with large chunks of cash in various random accounts. And because I have multiple accounts, when I need cash or want to reduce an investment holding, I don't know which position to sell. I need monthly bookkeeping. I am overwhelmed with the paper associated with numerous investment and banking accounts, with no overall summary. I am behind on my corporate tax returns. My will is out of date. My mother's affairs need attention. I find it all quite frustrating and unsettling and I'm sure I am wasting money. I would like to have my personal affairs run properly, like a business. But I can't do it myself."

As a family office, we specialize in fixing people's hassle maps and making their lives easier. Everyone's hassle map is different, depending on their personality and financial circumstances. But the common element in a proper financial management solution is clear goals, an integrated approach and proactive management, just like how you would run a business. Imagine!

Again, happy new year to each of you.

Tom

Where will the spotlight shine next?

Eric Weir, CFA, CFP

A skim through the headlines of last year's economic newsletters highlights one overarching theme -- sovereign debt problems. Articles on this and related topics dominated the news and economists dueled over what governments and central bankers should do to rescue their economies.

And of course the spotlight moved from one hot spot to the next as troubles emerged. It has roamed around Europe – focusing first on the PIIGS (Portugal, Ireland, Italy, Greece and Spain). In the summer, we saw the light shine on the United States when they reached their self-imposed debt ceiling. And then in the fall we saw a return to the Eurozone with Italy, and even France, receiving some of the attention. We think it's safe to predict that sovereign debt will once again dominate the world's financial headlines in 2012 as the drama continues.

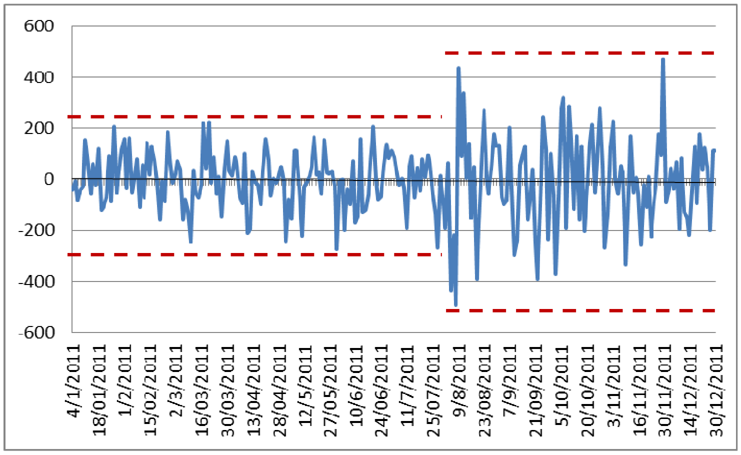
Looking behind the front pages of the papers, what will this mean for investors? We've taken a look at three themes we believe will be worth considering in the next year. CONTINUED ON PAGE 2…

NORTHWOOD FAMILY OFFICE
is a multi-family office providing comprehensive Net Worth Management™ to wealthy families and foundations.

CON'T FROM PG 1 … WHERE WILL THE SPOTLIGHT SHINE NEXT?

1. *Continued high levels of market volatility*

Despite the fact that sovereign debt problems were well publicized in 2010 and early 2011, volatility increased substantially in the summer and markets began to trade more erratically on rumours and press conferences in the Eurozone and in Washington. **In fact, 29 of the 126 TSX trading sessions in Q3 and Q4 (i.e. 23%) moved by more than 200 points!** The graph below shows the change in the TSX each trading day and demonstrates how volatility has increased over the course of the year.



We expect that this trend will continue into 2012.

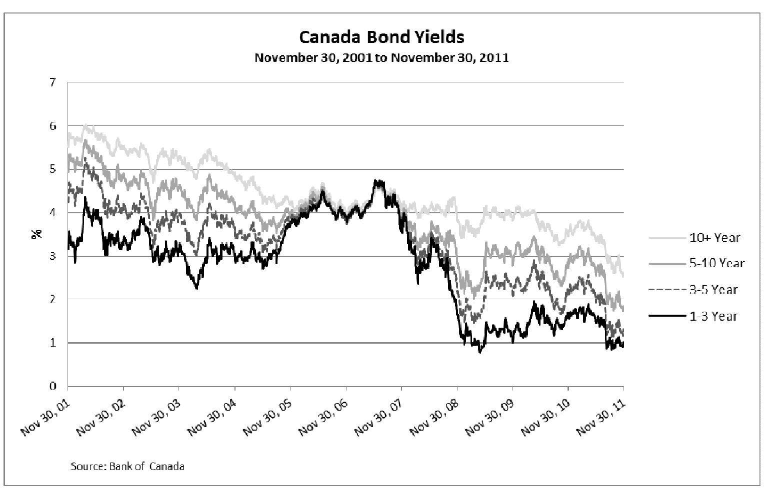
It is important to remember that volatility can be a double-edged sword. While it is generally viewed as negative and can make it harder for investors to stay the course, it can also provide opportunities. Investors with a strong conviction and a fundamental view on an asset class or investment can use the emotional rallies and swoons in markets (caused by the news of the day) to add to and lighten up positions as the market swings to the extremes. Clients of Northwood may notice a little more activity in the portfolios as our investment managers use volatility to add value to the portfolio in a tactical way.

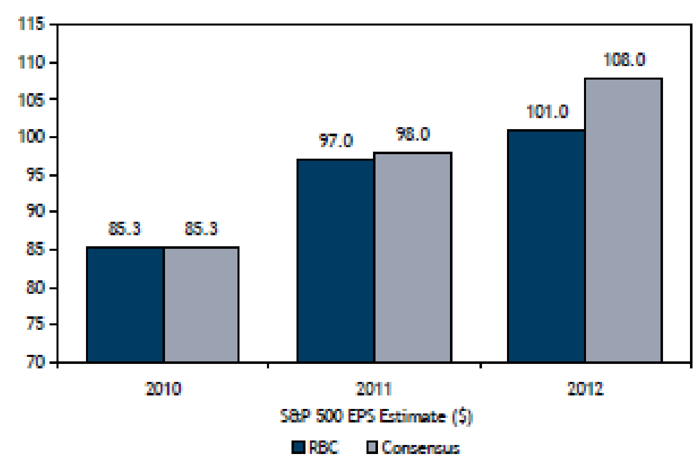
2. *Low interest rates*

At the beginning of 2011, most banks and investment firms were predicting that interest rates would begin to rise in the latter half of the year, and then continue to escalate to more normal levels in 2012 and beyond. As is often the case, 2011 proved the consensus view wrong as rates fell substantially in Q3, with 5 and 10 year yields now near their lowest levels in recent history. As the spotlight shines on the fragile nature of the world economies and governments are forced to cut spending, we expect that central banks will continue to keep rates low in 2012. They will be afraid to risk boosting rates and harming a fledgling recovery. While it is extremely difficult to foresee how rates could go much lower than they are today, it is very possible that they could remain at these extremely low levels in the short term as the debt spotlight continues to shine.

3. *Strong corporations*

Though the debt crisis has gripped sovereign governments, corporations have quietly performed extremely well. Balance sheets have been repositioned from 2008 and are now generally in excellent shape. The low interest rate environment has allowed companies to issue debt at extremely attractive rates. Profit margins have soared. The combination of these factors has translated into solid earnings levels and growth for most companies. This is well illustrated by the expectations that analysts have for companies in the S&P 500 (graph below). Regardless of whether you hold to the low growth or high growth view of the corporate world, there is definitely an expectation of corporate earnings growth in 2012. As the stock markets of the world continue to trade on the news of European summits and American Congressional super-committee meetings, investors may find some excellent opportunities to purchase very high quality companies that are continuing to grow. Investors could very well find these companies at sale prices when the spotlight shines on the next debt crisis.





Source: Thomson, RBC Capital Markets

Global Family Office Collaboration

Wigmore Association

Northwood is pleased to announce the formation of the Wigmore Association, an innovative collaboration of six leading family offices from around the globe. The group is composed of the Chief Investment Officers of each of the family offices and intends to share investment manager research, global investment perspectives and best practices for serving wealthy families.

Wigmore Association member firms come from across North America, Europe, and Australia. In addition to Northwood, the other founding members include HQ Trust (Germany), The Myer Family Office (Australia), Pitcairn (U.S.), Progeny 3 (U.S.), and Sand Aire (U.K.). We expect to add one additional family office from Asia and one from South America to the group within the next year.

We are very excited to be part of this global collaboration. The collective resources, assets and intellectual capital within this group are formidable. The opportunity to exchange ideas and share investment research with a group of this caliber will only enhance Northwood's ability to serve our clients and Canada's affluent families.

This enthusiasm is shared by leading U.S. multi-family office, Pitcairn. Dirk Junge, chairman and chief executive officer of Pitcairn, said: "At the semi-annual meetings that have been held this year, the CIOs have enjoyed a vigorous exchange of ideas and careful consideration of their application to the specific needs of multi-generational families." He added: "This global group allows each of the members to extend the reach of their investment intelligence gathering process."

Alex Scott, chairman of U.K.-based family office Sand Aire, added: "I have known all the partners in the Association for several years and am delighted that we have found the basis for collaboration. We do not compete with each other, and we recognize that we can benefit both our existing and prospective clients by building collaborative agreements with partners globally. I look forward to building upon these foundations."

Wigmore's next gatherings will take place in March 2012 in Melbourne, Australia and in September 2012 in Toronto.

Raising Children of Affluence

Barrett Lyons, CA, CFP

In late October, Northwood hosted Dr. Jim Grubman to speak on the topic of 'Raising Children of Affluence'. Dr. Grubman is a clinical psychologist, based near Boston, Massachusetts. His practice has evolved to the point that the majority of his time is now spent with families of wealth and advisors to those families, helping them deal with the psychological aspects of that wealth. One rapidly growing aspect of his practice is helping wealthy families think about how to properly raise and prepare children of affluence. The two sessions were very informative and well-received by both clients and friends of the firm alike.

A portion of Dr. Grubman's talk centered on the differences between what he calls 'immigrants to wealth' and 'natives of wealth' and the issues that raises.

Immigrants to wealth are those who arrived at their position of wealth within their lifetime. In fact, Dr. Grubman and his co-author, Dr. Dennis Jaffe, in an article called Immigrants and Natives to Wealth, suggest that 75-80% of Americans (and likely Canadians too) in the upper 2% of economic class, arrived at their economic position *during* their lifetime. In other words, they moved up from a lower economic class to a higher class.

Natives to wealth, on the other hand, are those who were 'born affluent' and have no history of transition from lower to higher economic class.

You can imagine the potential differences in the thought processes of these two groups and the dysfunctional communication that can result (especially between 'economic immigrant' parents and 'wealth native' children, for instance).

- Economic immigrants (just like geographic immigrants) carry with them their old (e.g. middle-class) culture as they climb the wealth ladder. They sometimes have trouble adapting to the new wealthier culture and frequently feel like 'imposters' in this 'new world'. "They must often guess how to act, spend, dress, even talk."
- Wealth's immigrants have experienced economic transition as a positive force: they have lived the American dream of overcoming hardship to achieve the good life. They know *risk* as *opportunity*….Whereas for natives, the family's transition upward may be a vague memory or a distant tale of long ago. Conservative as investors and cautious to preserve their status, they often think of financial risk as more likely to move them down the economic ladder. Because they themselves have no history of overcoming hardship, *risk* is seen as *danger*, not opportunity.

The fact that 80% of wealthy families attained that level in their lifetime, begs the question 'Why are only 20% natives'? CON'T ON PAGE 4

CONTINUED FROM PG 3 … RAISING CHILDREN OF AFFLUENCE

These skills are obviously not taught all at once. Through consistent application and encouragement throughout childhood, these abilities are formed and honed.

The unfortunate answer is that, in most cases, wealth is not sustained. The parents, it seems, can make the money but they can't teach their kids how to hang on to it. The next generation frequently finds themselves "deported from the land their ancestors struggled to reach."

In addition, Dr. Grubman laid out *The Core Financial Skills of Life*:

1. How to live within your means (spend at or below your income)
2. How to save
3. How to manage debt/credit
4. How to keep track of money
5. How to manage assets
6. How to get and keep a job (work ethic)
7. How to be charitable/philanthropic

This is a complex but fascinating issue and Dr. Grubman just scratched the surface in his presentation. But it obviously struck a chord among parents in attendance.

If you are interested in reading more, you can find the full *Immigrants and Natives to Wealth* article at the following address: www.jamesgrubman.com/immigrantsandnativestowealthjfpjuly07.pdf.

Additionally, we are more than happy to provide you with a reading list for parents compiled by Dr. Grubman, as well as the presentation handout. If you're interested, e-mail Mia Cassidy for your copy:

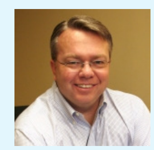
mcassidy@northwoodfamilyoffice.com

**Note: All quotes come from the article "Immigrants and Natives to Wealth" by James Grubman and Dennis Jaffe from the Journal of Financial Planning www.jamesgrubman.com/immigrantsandnativestowealthjfpjuly07.pdf*

Is it time to teach the old dog new tricks?

Should the approach to wealth planning change, given lower-return fixed income markets & higher-volatility equity markets?

Scott Hayman, CA, CFP



Equity markets have become much more volatile in the past several years and returns over the past decade have been significantly lower than long-term averages. In addition, most equity markets are now more highly correlated, which has reduced the benefits of diversification. On the other hand, fixed income markets have had a long run of excellent returns due to falling interest rates, which will not be possible to repeat. Fixed income returns in the future will not enjoy the falling yield curve that investors profited from over the last 30 years. The combination of these two significant changes has made investment and financial planning even more difficult than normal.

Given these significant changes, it would be fair to ask if the approach to wealth and financial planning needs to change to adapt to the new realities. And the answer is no.

We actually believe that the fundamentals of a goal-based planning model make sense in every environment.

For most clients, the central objective is achieving their family's life goals and objectives in two categories: Lifetime and Legacy. They need to ensure they can fund their Lifetime expenses (family lifestyle expenses, property acquisition and maintenance etc.) and have enough to achieve their Legacy goals (charitable giving, gifts, inheritance, possibly significant additional wealth creation etc.) A financial or wealth plan is designed to make sure this happens, with low probability of negative surprises. That hasn't changed.

But the new environment does require some adjustments. In a more volatile and lower-return environment the assumptions that the plan is based on must be reviewed regularly. As we all know, any output is only as good as the inputs that go into it.

When planning to achieve specific goals, the key measure to focus on is cash flow. In other words, is there enough money available (after all the outflows) and at the right moments in life to make sure you can achieve everything you want to achieve? Are the assumptions you are using realistic and updated to reflect current and expected conditions? Do you know what factors you can use to make changes as required? Are these factors 'controllable' (e.g. cutting expenses, working longer etc.) vs. out of your hands (e.g. capital market returns, longevity etc.)?

Let's have a look at the four factors that impact cash flow. Each of the components below will have a varying level of impact on your cash flow, depending on the magnitude and timing of the financial decisions you make.

1. How much you make
2. How much you spend
3. Time, and
4. Other resources

1. How much you make

This category includes income from all sources, including employment income and investment income (e.g. public investments, private investments, business ownership etc.). Employment income is affected by both the level of your income and how many years you choose to work. For many people, this is a relatively controllable input.

CONTINUED ON PAGE 5…

CONTINUED FROM PG 4… PLANNING IN NEW MARKETS

Investment income is impacted, at least in part, by the general economic environment, the asset mix you choose, and risk you are willing to take in your portfolio.

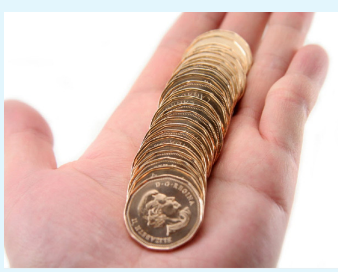
It wasn't all that long ago that people assumed a ten percent return was a pretty achievable, which made planning a lot easier. Of course, this assumption is long gone and would be quite misleading to use in return assumptions.

In the past decade, equity returns have been hard to come by due to the above-average returns of previous decades (i.e. borrowing from the future), extreme levels of debt, and economic uncertainty in many parts of the world. And, with interest rates at historical lows, it looks like it is going to continue to be tough to generate fixed income returns greater than the inflation rate for some time to come.

While prognosticators make predictions every day, the truth is that investment returns are difficult to forecast, and as such provide low-controllability in cash flow planning. The best approach is generally to use conservative return assumptions in financial plan calculations, and ensure that short-term and high-requirement goals are funded by the most conservative and least volatile asset classes. Longer-term and more 'optional' objectives can be funded with less predictable and potentially higher return assets.

Recent Assumption Update – Expected returns on fixed income portfolios are now lower given how much rates have already fallen. We have adjusted our long term fixed income return assumption down, however, we have maintained our inflation assumption at the previous level. This results in a reduction in the expected real return. This makes it even more important for investors to review the other three cash flow inputs to see if they should be making changes to them to compensate for the changes in investment returns. Of course, it is also important to review other asset classes to see if some of the desired expected return can be gleaned from other sources, but there is often a negative risk tradeoff which needs to be taken into account.

2. How much you spend



By comparison, your expenses are by far the most controllable factor that impacts your cash flow. It's not surprising, but for many people, this is also the most difficult component to change as it generally means adjustments to your lifestyle. Expenses also rise annually with inflation. And while inflation has remained low over the last several decades, real rates of return have been negative, putting many investors behind the eight-ball. The most prudent way to plan is to control the things you can control (e.g. expenses) and make conservative assumptions on the factors that are less controllable (inflation, investment returns).

Recent Assumption Update – Investors with shorter-time horizons who are potentially running a risk of fully depleting capital in today's expected low return environment should look closely at ways to reduce expenses. Recently, we have worked with a number of families to help them better understand their spending, the places they could reduce their spending, and ways they can better manage their total lifetime requirements.

3. Time

The third factor that impacts cash flow is an investor's timetable. This is related to your life expectancy and how many years of employment income you have left to build up savings to fund your lifestyle. Since time is uncontrollable (--unless you know when you will die!), investors need to take a conservative approach to life expectancy planning too. And the key is making sure you plan for living longer than you expect, so you don't run out of money.

Recent Assumption Update – Longevity is increasing and there is very good probability that within a family, the husband or wife will live to be at least 90 years old. Based on family history and a strong desire to be very conservative, we often assume life expectancies of age 100 for clients today. Recently, we've also had discussions with many families about options to continue to build their capital base due to the low return environment (i.e. delay retirement or sale of business). Adjusting this assumption can have dramatic impacts on expected outcomes.

4. Other Resources

Finally, other assets can be a significant factor in cash flow forecast and the overall planning process. This category includes assets that can be converted or sold to produce income. These are typically lifestyle assets (e.g. home, second property, art etc.) that, at a certain point in your life, you may find are no longer required or desired. Timing is often an issue with large assets, including the ability to make them liquid, so this should not be left until the last minute.

Recent Assumption Update – Given lower expected portfolio income to provide for expenses, many families are exploring the ideas of liquidating non-income producing assets earlier than expected. Recently, we are seeing more families consider the cost (capital and maintenance) of large assets such as vacation homes.

The current market conditions do not require a new approach to planning. The basic principles are sound and still apply. The key is to make sure the underlying assumptions are also sound and that you focus on controlling the factors you actually can control and estimate the other ones conservatively. This approach will serve you well in any environment. The current market environment poses significant challenges to investors putting faith in financial plans developed a decade ago. The financial landscape has changed over the past decade and making some general updates to your assumptions will prevent surprises from catching you off guard.

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For more information or to set up an appointment, please call Tom McCullough or Scott Hayman at

Main: (416) 502-1245 Email: tmccullough@northwoodfamilyoffice.com

www.northwoodfamilyoffice.com shayman@northwoodfamilyoffice.com

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